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BEFORE THE

SUBCOMMITTEE ON WATER AND POWER

COMMITTEE ON RESOURCES

UNITED STATES HOUSE OF REPRESENTATIVES

HOW THE FEDERAL POWER MARKETING ADMINISTRATIONS ARE IMPLEMENTING THE ENERGY POLICY ACT OF 2005 AND AN ASSESSMENT OF THE PROPOSED FISCAL YEAR 2007 BUDGETS FOR THESE AGENCIES

March 1, 2006

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to highlight Southwestern's efforts to market Federal hydroelectric power in its region and implement the Energy Policy Act of 2005 (EPACT) and to present an overview of Southwestern Power Administration's (Southwestern) Fiscal Year 2007 budget request.

PROFILE OF SOUTHWESTERN POWER ADMINISTRATION

Southwestern markets and delivers all available Federal hydroelectric power from 24 U.S. Army Corps of Engineers' (Corps) multi-purpose projects and participates with other water resource users in an effort to balance diverse interests with power needs. Southwestern operates and maintains 1,380 miles of high-voltage transmission line, 24 substations, and 47 microwave and very high frequency radio sites. Southwestern's Headquarters is in Tulsa, Oklahoma; the Dispatch Center is in Springfield, Missouri; and power system maintenance crews are based in Jonesboro, Arkansas; Gore, Oklahoma; and Springfield, Missouri. In Southwestern's region, Federal hydropower is distributed to nearly seven million end users in a six-state area: Arkansas, Kansas, Louisiana, Missouri, Oklahoma, and Texas.

Southwestern's program goal is to provide the benefits of Federal power to customers by selling and reliably delivering power from Federal multipurpose hydroelectric dams at the lowest cost-based rates possible that produce revenues sufficient to repay the American taxpayers' investments allocated to power (principal and interest), as well as operation and maintenance costs of the Southwestern Federal Power System.

MEETING REQUIREMENTS OF THE ENERGY POLICY ACT OF 2005

In support of the EPACT, the Administration's National Energy Policy goals, and transmission open access, Southwestern is participating in the Southwest Power Pool's Regional

Transmission Organization (SPP RTO), through a contract containing provisions consistent with those set out in the EPACT.

Consistent with the EPACT, the SPP RTO has indicated that it may consider working with the Department of Energy to seek designating portions of Southwestern's Federal transmission system as part of a National interest electric transmission corridor to serve significant load growth in northwest Arkansas.

Also consistent with EPACT, Southwestern has participated in meetings with the other PMAs, the Corps, and the Department of Interior Agencies to jointly report the potential to increase electric power production at federally owned or operated water regulation, storage, and conveyance facilities.

Southwestern, in coordination with the SPP RTO, is supporting regional electric reliability through the establishment of a training center at its Dispatch Center in Springfield, Missouri, to provide its system operators training courses certified by the North American Electric Reliability Council (NERC) in response to the blackout of August 2003. Training is also being provided to operating personnel from other utilities on a "space available" basis. Since April 2005, Southwestern has provided training to over 340 students and awarded over 3,000 Continuing Education units.

REGIONAL COOPERATION AND IMPROVING RELIABILITY

Southwestern has worked with the SPP RTO to identify needed improvements to the entire regional grid that will improve electric reliability and Southwestern plans to participate in these improvements and upgrades. Southwestern's budget forecast includes approximately $9,000,000 in upgrades to its Federal transmission system through FY 2010 to address these issues. Demonstrating its support to the region, Southwestern is represented in many planning

and operational committees of the SPP RTO. Southwestern chaired the Regional Transmission Organization's Coordinated Blackstart Taskforce and, based on the North American Reliability Council's requirements, developed the Blackstart Capability Plan and a Regional Restoration Plan.

In addition to working with the SPP RTO, Southwestern and a neighboring utility are in the process of completing a new interconnection to relieve overloads on the transmission system in northwest Arkansas. Southwestern is also discussing establishing an additional interconnection in southwest Missouri to provide further support to the region.

To promote improved reliability, communication, and system control, Southwestern is replacing its Supervisory Control and Data Acquisition system to provide monitoring and control of system operations. This upgrade will also provide the ability to improve communications between the Regional Reliability Coordinator and Southwestern's staff during emergency conditions.

SYSTEM COORDINATION

Following Hurricane Rita's devastating landfall in September 2005, Southwestern utilized the information learned during the development of the Regional Restoration Plan to help restore power to the people of southeast Texas. Hurricane Rita had downed hundreds of thousands of trees and numerous power lines in the region and left thousands of people and businesses in Jasper County and surrounding areas without electricity and telecommunications. More urgently, a hospital, water treatment plant, police departments, and other critical services were without the power they needed to respond to the disaster. Southwestern was instrumental in the coordination efforts between various customers and the Corps to use Federal hydroelectric power generated from Sam Rayburn Dam to provide power to these vital public services while repairs were made to bring power back to this hurricane-ravaged area.

SYSTEM RATES

To ensure repayment of the Federal investment, the Integrated System rates were adjusted to increase revenues by 7.3 percent ($9,000,000) effective February 1, 2006. This increase included an adjustment to Southwestern's purchased power adder rate component to recover increased costs of energy purchases. In addition, a revenue increase of 12 percent ($302,000) was implemented for the Sam Rayburn Dam project and a revenue increase of 43.1 percent ($195,000) was implemented for the Robert D. Willis project, both effective January 1, 2006.

FY 2005 ACCOMPLISHMENTS

- Southwestern marketed approximately 6.3 billion kilowatt-hours of energy and transmission services that generated revenues of $123 million.

- Southwestern has cumulatively repaid all annual operating costs and approximately 48 percent of the $1.2 billion in capital investments attributable to Southwestern's activities. All required capital investment payments have been made on time.

- Southwestern exceeded the NERC control compliance ratings for power system operations reliability.

- Southwestern saved 10.7 million barrels of oil, 3.1 million tons of coal, or 65.6 billion cubic feet of gas through hydropower generation, and prevented greenhouse emissions of approximately 5.4 million tons of carbon dioxide, 16,200 tons of sulfur dioxide, and 12,900 tons of nitrogen oxides.

- Southwestern provided $488 million in economic benefits to the region from the sale of hydroelectric power.

FISCAL YEAR 2007 BUDGET REQUEST SUMMARY

(dollars in thousands)

	FY 2005 Appropriation	FY 2006 Original Appropriation	FY 2006 Adjustments	FY 2006 Current Appropriation	FY2007 Request
Operation and Maintenance					
Program Direction	19,169	19,958	-200	19,758	20,782
Operations and Maintenance	4,639	7,042	-70	6,972	7,145
Construction	5,309	3,166	-32	3,134	3,612
Purchased Power and Wheeling (PPW)*	11,200	12,400	0	12,400	13,600
Subtotal, Operation and Maintenance	40,317	42,566	-302	42,264	45,139
Offsetting Collections, PPW	-2,900	-3,000	0	-3,000	-3,000
Alternative Financing PPW	-8,300	-9,400	0	-9,400	-10,600
Total, Operation and Maintenance	29,117	30,166	-302	29,864	31,539

*Estimated program costs based on average year purchases at pre-Katrina prices and with energy banks available.

BUDGET HIGHLIGHTS

Southwestern's FY 2007 budget request provides for maintenance, additions, replacements, and interconnections to assure a dependable and reliable Federal power system, which is an integral part of the Nation's electrical grid. Southwestern's budget request shows a modest increase, allowing Southwestern to maintain its aging transmission system while meeting the demands of increased regional power loads and alleviating power flow constraints. Participation in future transmission system projects to improve reliability will depend on greater use of non-Federal reimbursable authority for facility improvements, interconnections, and maintenance required by the security coordinator of the Regional Transmission Organization.

Program Direction

Program Direction provides compensation and all related expenses for 179 Federal personnel who market, deliver, operate, maintain, and administer the high-voltage interconnected power system and associated facilities. Southwestern performs critical functions in meeting the

challenges of operating and maintaining the Federal power system to assure reliability, while responding to the growing regional demand for power and avoiding deterioration of the infrastructure, including planning, designing, and supervising the construction of replacements, upgrades and additions to the transmission facilities, and marketing power and energy produced to repay annual expenses and capital investments with interest.

Operations and Maintenance

Operations and Maintenance funds routine repair, maintenance, and improvement of Southwestern's substations and high-voltage transmission lines, and assures power is reliably and safely delivered to customers. Southwestern's facilities, most of which were built some 60 years ago, are routinely evaluated through a maintenance management information system. The funding level is derived from variables such as age, risk of failure, life cycle of equipment, and field crew evaluation. Internal and external factors include obsolescence of technology and lack of replacement parts. This budget request reflects Southwestern's assessment of the funding required to assure continued reliability of the Federal power system by replacing aging equipment and removing constraints that impede power flows, thus, meeting the expectations of the National Energy Policy, EPACT, transmission open access, and the Department of Energy's Strategic Plan. Southwestern will continue to use appropriations and alternative financing arrangements, including net billing, bill crediting, and/or reimbursable authority (customer advances) to fund maintenance and replacements to assure a dependable and reliable Federal power system.

Construction

Construction provides funding for the addition, replacement, and modification of communication equipment and systems that provide monitoring and control of power system

generation and transmission assets. The funding for FY 2007 will complete an important communication pathway which will improve reliability in the region.

In December 2004, the Congress passed and the President signed the Commercial Spectrum Enhancement Act, creating the Spectrum Relocation Fund (SRF) to streamline the relocation of Federal systems from certain spectrum bands to accommodate commercial use. Funds will be made available to Southwestern following the crediting of auction receipts to the SRF, anticipated in fiscal year 2007. Southwestern estimates $6.3 million in relocation costs, as approved by the Office of Management and Budget, and as reported to the Congress by the Department of Commerce in December 2005.

Purchased Power and Wheeling

Purchased Power and Wheeling is based on average hydropower generation under normal operating conditions at pre-Katrina prices with energy banking assumed available. However, in FY 2006, a significant shift to a post-Katrina pricing regime and the loss of availability of energy banking arrangements will cause future years' purchase requirements to increase. Purchase Power and Wheeling will be funded through use of Federal power receipts and alternative financing arrangements, including net billing, bill crediting, and reimbursable authority or customer advances, and other operational arrangements with customers.

Southwestern will continue to utilize its Continuing Fund for emergency expenses associated with purchase power to ensure continuity of electric service and continuous operation of the facilities on an on-going basis to pay for purchase power and wheeling expenses when necessary to meet contractual obligations for the sale and delivery of power during periods of below-average hydropower generation. The fund was activated during fiscal year 2005 and again this fiscal year for purchased power and wheeling expenses during the extended drought we are experiencing in our region. As of mid-February, inflows are at 10% of median and the

available system storage for generation of hydroelectric power is approximately 11% below the previous 18-year minimum, which is only 8 percent above the 75-year all-time minimum. Pool levels at the reservoirs which supply Southwestern's hydroelectric generation resources are approximately half full.

Agency Rate Proposal

Starting in FY 2007, the interest rate for new obligations incurred by Southwestern for power-related investments will be set at the rate equivalent to what Governmental corporations pay when borrowing in the market, identified as the **agency rate**. This will align interest rates on certain investments with those paid by Bonneville Power Administration. This new interest rate will apply only to investments whose interest rates are not set by law. All Southwestern investments currently in service will continue to retain existing interest rates. This will result in a rate increase of less than 1 percent, beginning in Fiscal Year 2007.

CONCLUSION

In conclusion, Southwestern's Fiscal Year 2007 budget request will allow Southwestern to continue operating in a business-like manner and meet the requirements of the Energy Policy Act of 2005 while supporting the Nation's energy goals and the development of the transmission and generation infrastructure. As the demand for power increases on the Nation's transmission systems, the need to maintain, replace, and provide for additions and interconnections on the Federal power system is critical in assuring reliable delivery. Southwestern will continue to examine its overall business strategy while making the improvements necessary to ensure reliability of the Federal power system.

Mr. Chairman, this concludes my testimony. I would be pleased to address any questions the Subcommittee may have.